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STATEMENT OF THE CASE

The Securities and Exchange Commission seeks review of the decision of the Sixth Circuit Court of Appeals which reversed injunctions issued against Respondents William V. Coffey and John M. King. The lower court had enjoined the Respondents respectively as an "aider and abettor" and a "responsible officer" in a corporation, King Resources Company, which had purportedly engaged in a fraudulent scheme or deceptive practice in violation of Section 17(a) (1) and (3) of the Securities Act of 1933 and Rule 10(b)-5 (1) and (3) promulgated under the Securities and Exchange Act of 1934, (Appen. A p. 1a). The Sixth Circuit upon a review of the law and facts involved determined that the Commission had not shown sufficient participation by the respondents in the apparent securities violations in order to justify their injunction as individuals. The Sixth Circuit did, however, remand the case with respect to the Respondent William V. Coffey for further proceedings in order to determine whether or not he should be enjoined for violations of Section 17(a) (2) and Rule 10(b)-5 (2), prohibiting material misrepresentations or ommissions in connection with the sale of securities. The Sixth Circuit determined that the evidence was insufficient to justify further proceedings against the Respondent King. The Commission had alleged such misrepresentations on the part of Respondent and other defendants, but the lower court made no findings with respect to such allegations, (Appen. A pp. 10a-11a).

This case involves the loan of approximately $22,000,000.00 from the State of Ohio to four companies under authority conferred upon the State Treasurer by Ohio Revised Code Section 135.14. In the complaint filed

against 19 corporations and individuals including King Resources and the Respondents, the Securities and Exchange Commission alleged that the Respondents had engaged in a fraudulent scheme or deceptive practice in connection with the sale of some $8,000,000.00 of two year promissory notes of King Resources Company to the State of Ohio. The particular scheme or device alleged was the utilization of a "prime" rating issued by the National Credit Office, Inc., of New York in connection with the sale of the notes. The Securities and Exchange Commission maintained that the use of the prime rating was fraudulent because The National Credit Office prime rating is referrable to an insurer's ability to repay its short term commercial paper obligations, not its long term obligations which include two year loans (Appen. A pp. 12a-16a). The Sixth Circuit upon careful examination of the statute noted a number of latent ambiguities and concluded that by using the term "prime" in connection with the acquistion of loans from the State of Ohio, King Resources had merely complied with the law. It therefore rejected the Commission's theory that the use of the term "prime" in connection with the loans established a fraudulent scheme or practices. (Appen. A. p. 16a).

Neither of the Respondents participated directly in the acquisition of the loans from the State of Ohio. The loans were negotiated and made through a group of money finders including Crofters, Inc. The only concrete acts on the part of the Respondents shown by the Commission were those of William V. Coffey. When requested, Coffey prepared and forwarded information to both Crofters, Inc. and the National Credit Office. There has been no determination of whether or not any of the material supplied by Coffey was misleading. This subject is to be

considered by the District Court upon remand. The Circuit Court, noting that the Commission had failed to establish a connection between King and the loans and had best shown a remote connecton between Coffey and the loans, reversed the District Court's injunction of King and remanded the case with respect to Coffey for full consideration of his involvement. Since the evidence considered by the Court of Appeals on review indicated that Coffey's involvement in the loans was only minor, it instructed the District Court that Coffey should be enjoined only upon a showing that he acted with willful or reckless disregard of truth, if indeed it should be determined that he participated or aided in the promulgation of any materially misleading representations or omissions. (Appen. A pp. 17a-18a).

OBJECTIONS TO GRANTING A WRIT OF CERTIORARI

1. THE DECISION OF THE SIXTH CIRCUIT COURT OF APPEALS DOES NOT CONFLICT WITH THE DECISIONS OF OTHER COURTS OF APPEALS.

Petitioner argues that the Sixth Circuit's imposition of the standard of willful or reckless disregard of truth in this case for injunction is in "sharp conflict" with other circuits. Petitioner further suggests that other circuits have clearly indicated that negligence is the proper standard for all commission injunction proceedings. Respondents respectfully submit that the Sixth Circuit's decision in the present case is neither in conflict with decisions of other circuits nor have other circuits determined that negligence is the exclusive standard for culpability in Commission injunction proceedings.

The Petitioner first points to the Seventh Circuit's recent decision in *Securities and Exchange Commission* v. *Dolnick*, No. 73-1752, decided August 16, 1974 (slip opinion page 7). In that case the Seventh Circuit did state *in dictum* that it felt the Sixth Circuit's decision in the present case requiring a showing of willful or reckless disregard of truth was inconsistent with prior case law of that circuit. The Seventh Circuit referred to its decision in *Securities and Exchange Commission* v. *Van Horn*, 371 F. 2d 181 (C.A. 7). This case is also cited and quoted by Petitioner. In *Van Horn* the Seventh Circuit did state:

> It is no defense to an action for injunction * * * that the admittedly false statements were uttered without knowledge or that there was no intention to omit the disclosure of material facts. (*Securities Exchange Commission* v. *Van Horn*, 371 F. 2d 181, 186 (C.A. 7).

The holding of the Sixth Circuit in the present case does not conflict with this statement. On remand the Sixth Circuit instructed the District Court to enjoin the respondent Coffey upon showing that he acted with either willful or *reckless* disregard for the truth. Showing that Coffey acted knowingly or intentionally is unnecessary. At most, the Seventh Circuit in the *Van Horn* case precluded the requirement of a showing that Defendant Van Horn knowingly made representation or intentionally omitted material facts. The Seventh Circuit in *Van Horn* does not discuss minimum standards for culpability in Commission injunctive actions and has not precluded the requirement of willful or reckless disregard of truth as an element in every conceivable injunction action.

Petitioner also attempts to show conflict between the Sixth Circuit's decision in the present case and the Second Circuit's decision in *Securities and Exchange Commission* v. *Spectrum, Ltd.*, 485 F. 2d 532 (C.A. 2d). Respondents maintain that, if anything, the decisions are compatible. Petitioner argues that the Sixth Circuit's holding that aiding and abetting requires knowing and substantial assistance in a violation, (Appendix A p. 23a) conflict with statements in the *Spectrum, Ltd.* decision concerning the standards of culpability for persons remotely involved in a securities violation. As noted by the Sixth Circuit (Appendix A p. 23a N. 30), the Second Circuit's decision in the *Spectrum, Ltd.* case was carefully limited to the facts. In considering the *Spectrum, Ltd.* case the Sixth Circuit noted:

> We view the Second Circuit's decision in *SEC* v. *Spectrum, Ltd.*, 489 F. 2d Cir. 1973), as correct on its facts. Their lawyer was aware that his misleading opinion letter could be used to sell unregistered securities and failed to take timely steps to prevent

> such use. We do not believe that this application of a negligence standard to that situation compels us to apply a negligence standard in the very different case we confront. Here, there must be some showing that the Appellants were aware of Crofters' personnel's alleged misrepresentations. We not further that the attorney in *Spectrum, Ltd.* had committed three prior securities law violations, so that his argument of innocent knowledge was subject to doubt.

It is therefore clear that although the Sixth Circuit has imposed a standard of willful or reckless disregard of truth in the present case, it does not maintain that such a showing is necessary in every injunctive case. The Sixth Circuit's position is most aptly characterized as a willingness to determine standards on a case by case basis. This approach is consistent with the Second Circuit's decision in *Spectrum, Ltd.* Although the Second Circuit did impose a negligence standard in that case, it did not indicate that such a standard was proper in every case. In the closing passages of *Spectrum, Ltd.* the Second Circuit states:

> We could not conclude without emphasizing that the standard culpability we find appropriate for the author of an opinion letter in an action for injunctive relief only should not be construed to apply to more peripheral participants in an illicit scheme. . . . Those questions are not before us (*Securities Exchange Commission* v. *Spectrum, Ltd.*, 458 F. 2d 535, 2d (C.A. 2d)

The other cases cited by Petitioner do not support its position. *City National Bank* v. *Vanderboom*, 422 F. 2d 221, (C.A. 8), certiorari denied, 399 U.S. 905; *Myzel* v. *Fields*, 386 F. 2d 718, (C.A. 8), certiorari denied, 390 U.S. 951; *Stevens* v. *Vowell*, 343 F. 2d 374, (C.A. 10), all involve private damage suits.

2. THE DECISION OF THE SIXTH CIRCUIT COURT OF APPEALS DOES NOT PRESENT THE QUESTION OF WHETHER OR NOT IT IS NECESSARY IN A COMMISSION INJUNCTIVE SUIT TO SHOW THAT THE PARTY AGAINST WHOM MISREPRESENTATIONS WERE DIRECTED WAS ACTUALLY DECEIVED.

The Petitioner next maintains that the Sixth Circuit in the present case has made the right of the Commission to obtain injunctive relief dependent upon a showing that the purported victim of a securities violation was actually mislead. The Sixth Circuit's decision cannot properly be read in that context. What the Sixth Circuit actually determined is that the acts of the Respondents could not be properly be characterized as a deceptive scheme or practice under Section 17 (A)(1) and (3) and Rule 10b-5 (1) and (3). The Sixth Circuit remanded the case to the District Court for determination of whether or not the Respondent Coffey engaged in any materially misleading representations or omissions under Section 17 (A)(2) and Rule 10b-5(2), (Appendix A p. 16a- 17a). Contrary to Petitioner's suggestion, the remand is without any requirement that the Petitioner show that the purported victim of the securities violation was actually misled as a precondition to the issuance of an injunction.

Discussion of Petitioner's contention leads back to the somewhat bizarre circumstances underlying this case. As noted in the Statement of the Case, the State of Ohio made loans to a number of businesses, one of which was King Resources, pursuant to Ohio Revised Code Section 135.14. The code section provides in part that:

> In addition to the investments specified in subparagraphs (A), (B), (C), and (D) of this section, the treasurer of state may invest interim moneys of the

> state in commercial paper notes issued by any corporation for profit which is incorporated under the laws of the United States, a state, or the District of Columbia, which such notes are rated prime by the National Credit Office, Inc., New York, or its successor, provided that the aggregate total amount of interim moneys invested in commercial paper at any time shall not exceed fifty million dollars.

The Sixth Circuit noted a number of latent ambiguities in the provision, (App. A Pages 11a - 16a). The provision, if read literally, authorizes the State of Ohio to invest in "notes" rated prime by the National Credit Office, Inc., New York. Interestingly, the National Credit Office does not rate notes at all; it rates companies with respect to their ability to meet short term obligations. Furthermore, notes are not short term obligations within the usages of the trade. Short term obligations are generally considered to be commercial paper payable within two hundred seventy or less days. Notes are generally considered to be of longer duration. To further complicate matters, the Ohio Attorney General has construed Ohio Revised Code Section 135.14 as allowing the State to invest in obligations with a term in excess of two hundred and seventy days, notwithstanding the statutes reference to commercial paper and to prime ratings. (Appendix A p. 14a n. 19).

King Resources procured several two year loans from the State of Ohio under Ohio Revised Code Sec. 135.14. In order to qualify for such loans King Resources procured a prime rating from the National Credit Office, even though the prime rating referrable to the company's ability to repay short term loans was perhaps irrelevant to its ability to pay long term loans. The Commission succeeded in convincing the District Court that the utili-

zation of the term "prime" in connection with the procurement of loans in excess of two hundred seventy days was *per se* a deceptive scheme or practice under Sec. 17(A)(1) and (3) and Rule 10b5 (1) and (3). The Sixth Circuit overruled the lower court on a very sensible basis:

> Under these circumstances, we cannot characterize a companys use of NCO's "prime" rating on its commercial paper and seeking to sell two-year notes in the State of Ohio is a fraudulent scheme or a deceptive practice. King Resources use of its "prime" rating was mandated by state law as a pre-condition to selling its notes to the State, so that the state cannot, as a matter of law, have been defrauded by such use (App. A p. 15A).

The Sixth Circuit's emphasis here is that the State of Ohio could not have been victimized by a fraudulent scheme or deceptive practice in this situation because the State of Ohio had itself dictated the use of the term "prime" in connection with the purchase of the notes. It should be re-emphasized at this point that the Sixth Circuit's holding is referrable to a scheme or practice and not to representations. Again, matters pertaining to alleged misrepresentations or material omissions may be considered on remand.

CONCLUSION

These Respondents respectfully submit that the decision of the Sixth Circuit Court of Appeals does not conflict any decision of any other Court of Appeals on any point of law, and further that the conclusions of law made by the Sixth Circuit when considered in light of the particular circumstances of this case, as intended by the Sixth Circuit, are correct and do not create any substantial problems with the administration of the federal securities law.

WHEREFORE, these Respondents pray that the Petition for a Writ of Certiorari to the Sixth Circuit Court of Appeals be denied.

Respectfully submitted,

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